MINUTES
of the
THIRD MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

August 19-20, 2013
Salon Ortega, National Hispanic Cultural Center
Albuquerque

The third meeting of the 2013 Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Senator Carlos R. Cisneros, chair, on Monday, August 19, 2013, at 10:02 a.m. in the Salon Ortega of the National Hispanic Cultural Center in Albuquerque.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Sen. Lisa A. Torraco (8/20)
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley (8/20)

Absent
Rep. Brian F. Egolf, Jr.
Rep. Henry Kiki Saavedra

Designees
Sen. William F. Burt
Rep. Jason C. Harper (8/20)

Rep. Donald E. Bratton
Sen. Jacob R. Candelaria
Rep. Ernest H. Chavez
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco

Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. John M. Sapien
Rep. Carl Trujillo
Rep. Luciano "Lucky" Varela
Sen. Pat Woods

(Attendance dates are noted for members not present for the entire meeting.)

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Jennifer Dana, Intern, LCS
Tessa Ryan, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Monday, August 19

Premium Tax Update
John G. Franchini, superintendent of insurance, and Jolene M. Gonzales, deputy superintendent of insurance, provided some background on the newly formed Office of Superintendent of Insurance. By law, the office became independent of the Public Regulation Commission on July 1, 2013. A nine-member committee oversees the office, which reports to the committee quarterly. The first reporting is scheduled for the end of October.

Superintendent Franchini and Ms. Gonzales gave an overview of the premium tax. The tax applies to insurance companies, health maintenance organizations, New Mexico casualty companies, nonprofit health care plans, prepaid dental plans, property bail bond agents, purchasing groups, risk retention groups, self-insureds and title insurance companies. Generally, insurers pay quarterly at a rate of 3.003% of gross premiums and membership and policy fees collected. Certain health insurers also pay a surtax of 1.0% on all but dental- or vision-only and other exempted premiums, for a total of 4.003%. The superintendent stated that this combined rate distinguishes New Mexico as having the fifth-highest premium tax in the country. However, per New Mexico law, the premium tax is in lieu of all other taxes except property taxes; therefore, the premium tax and property taxes are the only taxes that an insurer in New Mexico might pay. Responding to a question from a committee member, Superintendent Franchini indicated that he would ask a representative of the National Association of Insurance

Commissioners and report back to the committee on whether the ranking measure is based on insurers' effective tax rates.

Superintendent Franchini and Ms. Gonzales continued by describing other facets of the premium tax. Taxpayers may deduct returned premiums, certain government-purchased premiums, dividends paid to policyholders and premiums received from authorized companies for reinsurance on New Mexico-based risks. Taxpayers receive a 50% credit of payments made to the Health Alliance Pool and 50% for certain payments made to the New Mexico Medical Insurance Pool (MIP). For payments to the MIP that are attributable to policyholders who receive premiums in whole or part through certain programs — the federal Ryan White Comprehensive AIDS Resources Emergency Act of 1990, the Ted R. Montoya Hemophilia Program of the University of New Mexico (UNM) Health Sciences Center, the Children's Medical Services Bureau of the Public Health Division of the Department of Health or any other program receiving state funding or assistance — an insurer receives a 75% tax credit. Lastly, by statute, a refund or credit for an erroneous payment may be made up to three years after the payment.

Once the premium tax is collected and deposited into the Office of Superintendent of Insurance Suspense Fund, portions are distributed to certain other funds: the Insurance Operations Fund; the Fire Protection Fund; the Law Enforcement Protection Fund; and the Carrie Tingley Crippled Children's Hospital Program Fund. Revenues to the suspense fund have declined since a recent peak in fiscal year (FY) 2010 of over $231 million; in FY 2013, they amounted to nearly $185 million.

Superintendent Franchini highlighted some current and recent revenue and distribution figures and some areas of potential legislation that the office is considering for introduction in a future session.

Committee members raised concerns about the federal Patient Protection and Affordable Care Act's effects on health insurers and the state, including on providers' income, the state's medical insurance pool and credits that insurers may take for payments to the pool. Senator Cisneros invited the presenters to examine these and other issues raised and to present potential legislation for the committee's consideration at a future meeting.

New Mexico Film — Update and Film Production Tax Credit Annual Report

Nick Maniatis, director of the New Mexico Film Division, Economic Development Department, reviewed film production tax credit data and recent changes to the credit. He commented that the credit's annual cap of $50 million does not appear to have deterred companies from filming in the state in order to take advantage of it. For FY 2013, nearly $214 million was directly spent in the state; the figure does not reflect workers' personal consumption spending. During that time, there were 216,461 worker days.

Mr. Maniatis highlighted the following legislative changes to the credit.

- A company filming a television series with an order of at least six episodes, each with a budget of at least $50,000, may qualify for a 30% refund of certain direct production expenditures.
- A company that uses a qualifying production facility in filming other types of productions may add 5% to the 25% credit base for resident crew wages and fringe benefits when certain criteria are met. The provision is intended to promote the hiring of more in-state workers.
- Certain LLCs may claim the credit.
- A company claiming the credit for a full-length feature must include a New Mexico government logo in the credits.

Mr. Maniatis indicated that a commissioned three-year study to analyze the cost-effectiveness of film incentives is scheduled to start on September 1. The cost and difficulty of the study and the office's budget influenced the study's three-year duration. A member questioned whether three years is too long to wait for results and encouraged Mr. Maniatis to explore options to undertake the study more expediently.

State Land Office (SLO) Annual Status and Revenue Update

Ray Powell, commissioner of public lands, presented an annual SLO revenue and status update. He emphasized the importance of protecting the health and productivity of state trust lands for future generations.

Commissioner Powell's revenue update includes historic and estimated future income figures. Among other factors, past and future calculations are based on the production yield and prices of oil and gas. The second-highest amount of revenue from state trust lands in a fiscal year, $577.5 million, was yielded in FY 2013. FY 2012's revenue yield ($652.3 million, a record high) is largely attributed to that period's global demand for oil and gas, the production of which constitutes the vast majority of state land revenues. Estimated FY 2014 revenue is $635.9 million, and estimated FY 2015 revenue is $610.0 million; figures are based on a five-year trend and UNM's Bureau of Business and Economic Research five-year forecast for oil and gas. The FY 2015 estimate closely mirrors that of FY 2014 but reflects a slight increase in income from commercial and surface resources.

Commissioner Powell reviewed state land revenue distribution. Revenue from renewable sources is diverted to the SLO Land Maintenance Fund; it then pays for SLO operations and is distributed, according to the amount of revenue earned on respectively held lands, to beneficiaries. Revenue from nonrenewable sources is diverted to the land grant permanent funds (LGPFs); some of that revenue is invested and the remainder is distributed to beneficiaries.

Commissioner Powell discussed policies in the leasing of state lands. Though companies working on renewable energy projects to capitalize on the state's wealth of renewable energy are increasingly applying for and entering into leases, inadequate intrastate transmission infrastructure to export that energy to market has retarded more robust development.

Commissioner Powell described some of those renewable energy projects. In addition to renewable energy leases, the SLO supports projects that improve the economic health of the state and its residents by having companies locate in the state; some of those projects include the Sandia Science and Technology Park and the Mesa del Sol Innovation Park.

Commissioner Powell indicated that five years ago, for reasons he could not identify, the state traded with UNM the commercial property at Mesa del Sol for a less valuable apple orchard in Dixon. UNM then sold the commercial property to a developer. The orchard has since been badly damaged by fires and floods, and the SLO has been trying to salvage the trees.

RSTP members expressed concerns about the state's future needs and the LGPFs' ability to help to satisfy those needs. One member cited a recent study that indicated that by 2030, the ratio of people whose net contribution to government exceeds their distribution to those whose net distribution exceeds their contribution would grow to 1:1. If true, this would strain state resources, making even more critical the good health of the LGPFs and other funds. The member stressed the need for the state to ensure that it will meet its future revenue requirements.

A committee member asked Commissioner Powell about the current federal Bureau of Land Management's disposing of land at low cost. Commissioner Powell responded that the state is working with its congressional delegation to attempt to receive federal land at no cost but that it is also exploring the purchase of federal land.

Approval of Minutes

Upon a motion made and seconded, the minutes of the July RSTP meeting were approved without any changes.

Severance Tax Bonding Overview

Stephanie Schardin Clarke, director, State Board of Finance, gave an overview of severance tax bonding. Some revenue from the severance tax, one of the several taxes on natural resource production, is diverted to the Severance Tax Bonding Fund and some is diverted to the Severance Tax Permanent Fund (STPF). Subject to certain capacity restrictions, money in the Severance Tax Bonding Fund is used to service severance tax bonds, which are sold to finance capital improvements. Originally, a statutory cap of 50% of the previous year's bonding fund revenue applied to the amount available for debt service. Beginning in 1999 and as a result of a lawsuit requiring that the state more fully fund public school capital improvements, the cap increased to 95%, 50% of which services senior bond debt and 45% or more of which services debt on supplemental severance tax bonds.

Ms. Schardin Clarke presented a chart showing severance tax contributions to the STPF and noted that the contributions have fluctuated for two key reasons. First, the value of the resources from which the tax derives is volatile; second, statutory requirements produce fluctuating contributions from year to year. That is, "statutory capacity" (95% of the previous year's bonding fund revenue) and "cash available" (the current fiscal year's revenue) are considered in determining the amount of contribution. The amount for bond debt service is the statutory capacity calculation or the cash available figure, whichever is less, and the fund deposit is the amount of revenue remaining. The following principles illustrate how this arrangement affects that deposit amount.

- When in a year there is less revenue than in the previous year and the cash available amount is lower than the statutory capacity amount, the entire cash available amount is used for debt service and there is no fund deposit.
- When in a year there is greater revenue than in the previous year, the statutory capacity amount is lower than the cash balance amount, so the statutory capacity amount is used for debt service and the remainder is deposited into the fund.

Ms. Schardin Clarke outlined some considerations of note if a change in the structure of the STPF were contemplated. She commented that investment in the fund and payment for capital projects are both productive uses of the revenue. Capital project funding helps the state through short-term economic stimulation, while fund investment provides a less immediate — but nevertheless gainful — payoff; without the distributions it provides, another source of revenue would need to be tapped or an existing source would need to be expanded. But STPF investing carries risk. Meanwhile, strategically chosen capital assets improve the state's economic productivity. Possible alternatives to the existing forms of investment include lowering the taxpayer burdens, spending revenue in a different way and, like some natural resource-rich states, making direct distributions to households.

Investment Performance for FY 2013; Impact of Contributions and Distributions on the Permanent Fund; New Mexico Private Equity Overview

State Investment Council (SIC) Report

SIC representatives Steven K. Moise, state investment officer, Vince Smith, deputy state investment officer, and Charles Wollmann, communications director, updated the committee on FY 2013 investment performance and on the STPF and the LGPFs, and gave the committee a brief overview of the state's private equity program.

In FY 2013, the SIC representatives reported, permanent fund investments performed well compared with the SIC target (7.5%), policy benchmarks and peers. The investments realized a 13.28% return. The Wilshire Trust Universe Comparison Service ranked the LGPFs' last-quarter performance in the nineteenth percentile among comparable funds. The SIC representatives remarked that despite this good performance, 7.5% remains a prudent target rate of return since markets can be fickle, and having a higher target could induce investments that carry too much risk.

The SIC representatives expressed concern about recent reductions in contributions to the STPF resulting from the relatively high proportion (95%) of its revenue dedicated to bonding. The highest fund value, reached in October 2007, of $4.803 billion exceeded its June 2013 value by $656 million, which marks a 13.7% decrease. By comparison, the LGPFs' value has increased since that time — when it, too, reached a record high — by $731 million, or 6.5%. As a result of the STPF's and the LGPFs' respective performances in these time periods, the STPF distribution to the general fund decreased by $21 million, and the LGPFs' distributions — despite a decreased statutory distribution rate — increased by $14 million. Flagging growth to the STPF results in lower distributions to the general fund and public schools. The SIC representatives indicated that the SIC would welcome a legislative request for a select group of specialists to study ways to increase contributions to the STPF.

Over time, the LGPFs' and the STPF's distribution rates have diverged, despite being managed similarly: the LGPFs increased 4.9% each year on average and the STPF by 1.7%. The difference is attributable to the degree of the SIC's investment flexibility and the amount of inflows into each fund.

Representatives of the SIC gave an overview of the private equity investment program before introducing presenters from Sun Mountain Capital, who provided more detail on it. The program's aim is to spur economic development and yield investment returns. Although 9% of the STPF is authorized to be invested in private equity funds, the SIC has identified 5% as an appropriate investment level.

New Mexico Private Equity Investment Program Report

Sun Mountain Capital managing partner, Brian Birk, and partner, Sally Corning, outlined key aspects of the state's private equity investment program. A portion of the STPF is invested in private equity funds, which in turn invest in a broad range of New Mexico-based companies. A list of companies invested in through the program was distributed to committee members. To qualify for investment through the program, a company must have a presence in New Mexico.

In its first 10 years, the program's sole focus, which led to low financial return, was economic development. In its last 10 years, the focus has been on achieving financial returns close to competitive national benchmarks. The change in focus resulted in a shift from net financial loss to net financial gain — and performance in line with national venture capital benchmarks.

Mr. Birk and Ms. Corning summarized the private equity investment program's status. The program has rebounded from the 2008 market crash and is making new commitments: at present, over $350 million has been committed to 28 venture capital funds. In response to questions from committee members, Mr. Birk and Ms. Corning indicated that they would welcome a legislative effort to create a plan to analyze the mission and health of the STPF.

The committee recessed at 4:40 p.m.

<u>Tuesday, August 20</u>

The committee reconvened at 9:12 a.m. on Tuesday, August 20, 2013, with Senator Cisneros chairing the meeting.

Gaming — Revenue, Trends and Tribal-State Revenue Sharing

Representatives from the Gaming Control Board (GCB), Paulette Becker, board member, Frank A. Baca, general counsel and acting executive director, and Tom Fair, director of the Audit and Compliance Division, Taxation and Revenue Department, updated the committee on gaming revenue, trends and tribal-state revenue sharing.

In the past seven years, revenue from gaming has generally grown. It fell during the recession and then rebounded to its current level, approximately $130 million. Net racetrack revenue increased from 2006 to 2009 and then began a general decline. Meanwhile, tribal net revenue has generally increased. Historically, the majority of gaming revenue came from racetrack casinos; a shift, likely permanent, took place in FY 2010, when more revenue came from tribal sources than from racetrack casinos. These trends might be attributable to the opening of the Northern Edge Navajo Casino; competition from legal and illegal gaming in Mexico; and the growing concentration in certain geographic regions of gaming facilities, which results in a saturation of these facilities.

The GCB representatives also provided information on generated revenue relative to the agency's budget, tribal and racetrack net win amounts by year, estimated future gaming revenue (predicted to remain relatively constant) and the net impact on state revenue of the presence of tribal casinos. The amount of revenue from the tribal sources results in part from policies embodied in statute, rule and compacts.

A committee member commented that different priorities underlie the state's gaming policies. Some laws are designed with the purpose of revenue generation while others are intended as mechanisms to enhance economic development and infrastructure on tribal land. Other members discussed the issue of saturation and possible limits on the number of opportunities for gaming.

Senator Cisneros invited the presenters to examine issues related to the structure of the state's gaming system and present potential legislation for the RSTP's consideration at a future meeting.

New Mexico Lottery Revenue Update and Legislative Lottery Scholarship Fund Status

<u>New Mexico Lottery Report</u>

Tom Romero, chief executive officer, New Mexico State Lottery (NMSL), and Adriana Binns, director of marketing and communications, NMSL, gave an update on lottery revenue.

Mr. Romero pointed out that, in spite of an FY 2013 record-high deposit ($44 million), the Lottery Tuition Fund is strained because more students are attending college and associated rates are increasing. The record deposit came amid prior years' declining sales and was largely due to four Powerball run-ups and an increase in instant sales of about $1.3 million from FY 2012.

This year's estimated returns are $40 million, about the same as estimated for the next few years. Nevertheless, because of the NMSL's commitment to giving more students an opportunity to take advantage of the program, it has embarked on some initiatives to increase sales. Those initiatives include the following:

- restructure the Scratcher ticket prizes to offer better odds and more winners;
- sponsor Scratcher promotions to give players a second chance to win substantial prizes with their non-winning tickets; and
- refresh the Scratcher brand and introduce a new Scratcher logo through a high-energy campaign.

The NMSL is exploring: the creation of a subscription club, which would also allow for internet wagers; whether to offer video versions of traditional lottery games; and whether to offer higher payouts on premium national games. Further, it is identifying options for addressing a problematic statutory requirement that, each month, 30% of each previous month's gross revenue be deposited in the Lottery Tuition Fund.

Higher Education Department (HED) Report

José Z. Garcia, secretary of higher education, informed the committee about the status of the Lottery Tuition Fund. For FY 2014, there is an anticipated shortfall of $10.2 million in what will be owed to educational institutions. By FY 2018, under the assumption that tuition — and therefore lottery payment requirements — will increase by 4%, that shortfall is expected to increase to about one-half of what will be owed. Secretary Garcia stressed that this is a large-scale problem that needs an appropriately scaled solution.

Secretary Garcia reviewed FY 2013 lottery scholarship awards and payments to recipient institutions, noting that 69.8% of awards were given for research institutions, 9.4% for comprehensive institutions and 20.8% for two-year institutions. Because of schools' varying tuition and fee levels, 88.1% of payments went to research institutions, 5.5% to comprehensive institutions and 6.5% to two-year institutions.

Secretary Garcia also reviewed some data on family income of students receiving the scholarship and on retention of recipient students. Of the spring 2012 first-time recipients, 1,294 came from families whose annual income was under $30,000; 933 came from families whose annual income was greater than $120,000. Eleven percent of all recipient students did not file a federal financial aid form — so information on their families' annual income is unknown. Over time, the percentage of recipient students who continue enrollment decreases. An average of 75.2% of first-time recipient students remain enrolled in the next semester and 63.9% in the next.

Lastly, Secretary Garcia turned committee members' attention to a table of legislatively proposed solutions to the lottery shortfall problem and highlighted Senate Memorial (SM) 101 (2013 session). SM 101 requested that the HED form a work group to study the solvency of the Lottery Tuition Fund and to make recommendations to improve solvency. Secretary Garcia reported that the group had its first meeting in July and will discuss options at its second meeting in September. In October, it will decide on recommendations. A committee member requested that the HED transmit the report containing those recommendations to the committee.

Committee members and Secretary Garcia discussed some aspects of and recommendations concerning the lottery shortfall problem, including that: a per-pupil cut would disproportionately affect students from lower-income families; the arrived-at solution should affect as few students as possible; the state should consider eliminating the qualification requirement that a student attend college immediately after high school; more students attending two-year colleges would help to defray lottery tuition payments, since those schools charge less in tuition; and incorporating in the scholarship incentive a graduation requirement would deter dropping out.

Adjournment

There being no further business, the RSTP adjourned at 11:12 a.m.